

Fundamentals Level – Skills Module

# Taxation (Hong Kong)

Monday 7 December 2009

**Time allowed**

Reading and planning: 15 minutes

Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.  
Tax rates and allowances are on page 3.

**Do NOT open this paper until instructed by the supervisor.**

**During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.**

**This question paper must not be removed from the examination hall.**

**The Association of Chartered Certified Accountants**

# Paper F6 (HKG)

# ACCA

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**The question paper begins on page 3.**

## SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings should be rounded down to the nearest HK\$.
2. Apportionments need only be made to the nearest month, unless the law and prevailing practice require otherwise.
3. All workings should be shown.

## TAX RATES AND ALLOWANCES

The following 2008/09 tax rates and allowances are to be used in answering the questions.

### Allowances

	\$
Basic allowance	108,000
Married person's allowance	216,000
Single parent allowance	108,000
Child allowance – 1st to 9th child (each)	50,000
– additional allowance in the year of birth (each)	50,000
Dependent parent/grandparent allowance – basic	15,000/30,000
– additional	15,000/30,000
Dependent brother/sister allowance	30,000
Disabled dependant allowance	60,000

### Deductions

	\$
Self-education expenses (maximum)	60,000
Home loan interest (maximum)	100,000
Elderly residential care expenses (maximum)	60,000
Mandatory provident fund contributions (maximum)	12,000

### Tax rates

Salaries tax rates:	
First \$40,000	2%
Next \$40,000	7%
Next \$40,000	12%
Remainder	17%
Standard rate	15%
Profits tax rate for corporations	16.5%

\* 100% of salaries tax and tax under personal assessment for the year of assessment 2008/09 will be waived subject to a ceiling of \$8,000.

### Depreciation allowance rates

Initial allowance:	
Plant and machinery	60%
Industrial buildings	20%
Annual allowance:	
Computers	30%
Motor cars	30%
Furniture and fixtures	20%
Machines	20%
Industrial buildings	4% or formula
Commercial buildings	4% or formula

**ALL FIVE questions are compulsory and MUST be attempted**

- 1 White is employed by Cyber Inc (Cyber), a company incorporated in the USA, as regional finance director. His employment contract was discussed and signed in New York and his salary is paid direct into his bank account in New York. Since 2006, he has been based in the Hong Kong office but is required to travel within the region when necessary. During the year ended 31 March 2009, he made the following trips:

PRC	120 days
Other Asian countries	50 days
USA	55 days (including 15 days annual leave)

For the rest of the year, he stayed in Hong Kong and did not take any annual leave in Hong Kong.

The following additional information for the year ended 31 March 2009 relates to White (all amounts are denominated in Hong Kong dollars):

- (1) Annual salary: \$1,200,000.
- (2) Directors' fees: \$30,000 from the Hong Kong subsidiary of Cyber. The subsidiary trades with exporters in the South-East Asian countries. Although it holds all its directors' meetings in Hong Kong, the subsidiary acts as a rubber stamp for decisions made by Cyber. Occasionally White acts as an alternative director of the subsidiary.
- (3) White lives with his family in a serviced apartment in Causeway Bay. The cost of the apartment is \$25,000 per month and this was paid by the Hong Kong subsidiary. White paid \$10,000 to join the clubhouse and was reimbursed this amount by Cyber.
- (4) Cyber provided White with a car and a driver. The car was leased from a car agency in the name of Cyber, at a monthly rental of \$5,000. The driver was hired at \$8,000 per month by Cyber. The total petrol and maintenance costs for the car for the year were \$50,000, all of which were paid for by White and reimbursed by Cyber. White estimated that about 20% of the usage of the car did not relate to Cyber's business.
- (5) Cyber employed an amah for White at a cost of \$4,000 per month and refunded White his utilities bills, which were \$30,000 for the year.
- (6) Cyber has set up an educational trust. The trustee made a grant of \$24,000 to White's son who is studying in Canada.
- (7) Cyber operates a medical insurance scheme for all its employees through an insurance company, and pays an annual premium of \$5,000 per employee. During the year, White was hospitalised for two weeks. In order that he could continue to carry out his employment duties whilst in hospital, he paid an extra \$21,000 for a private room. The basic hospital fees and public ward fees of \$40,000 were reimbursed by the insurance company, while two-thirds of the extra fees were reimbursed by Cyber.
- (8) White purchased a personal computer for \$10,000. The computer was helpful for producing financial analyses and he used it exclusively for work purposes.
- (9) During the year, Cyber received and paid the following tax bills in respect of White:

Hong Kong salaries tax	\$60,000
PRC individual income tax	\$160,000
Other Asian countries' income tax	\$40,000
- (10) White contributed a total of \$18,000 to the Mandatory Provident Fund.
- (11) White is married with two children, aged 24 and 15. The elder child is studying full-time in Canada (see note (6)).

**Required:**

- (a) Determine whether White is subject to salaries tax in Hong Kong in respect of the income described in (1) and (2) above and if yes, on what basis. (7 marks)

- (b) Based on your explanation in part (a) above, calculate the Hong Kong salaries tax liability of White for the year of assessment 2008/09.

Note: you should ignore provisional tax and overseas tax.

(12 marks)

- (c) Briefly explain the tax treatment you have applied to items (4), (6), (7) and (8) above.

(6 marks)

**(25 marks)**

- 2 Professional Services Ltd (PSL), a Hong Kong incorporated company, provides professional teaching services. PSL's profit and loss account for the year ended 31 December 2008 is as follows:

	Note	\$	\$
Income			
Service income	(1)	800,000	
Interest income	(2)	27,000	
Profit on disposal of fixed asset		5,000	832,000
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Expenses			
Directors' fees		200,000	
Salaries and wages		400,000	
Legal and professional fees	(3)	50,000	
Provident fund	(4)	60,000	
Depreciation		56,000	
Insurance		3,500	
Bank charges and interest	(5)	20,000	
Exchange gain	(6)	(1,000)	
Travelling costs	(1)	14,000	
Advertising		11,000	
Printing and stationery		30,000	
Provision for accounts receivables	(7)	(2,000)	
Donations to Hong Kong Community Chest		8,500	
Sundry expenses	(8)	63,000	(913,000)
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Loss before tax			(81,000)
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The following information, extracted from the audit working papers, gives further details of PSL's operations during the year:

- (1) During the year, PSL gave two seminars in Singapore, for which it received total remuneration of \$220,000. The remuneration covered learning materials, seminar facilitators and other teaching related equipments. The travel costs from Hong Kong to Singapore for the facilitators totalled \$14,000.
- (2) Interest income comprises the following:
  - (i) \$20,000 from a US\$ fixed deposit placed with HSBC, New York branch
  - (ii) \$6,000 from a HK\$ savings account placed with HSBC, Hong Kong branch
  - (iii) \$400 from the HKSAR government accrued on various tax reserve certificates purchased by PSL during the year. The certificates are to be used to settle any Hong Kong tax liability of PSL if required in future.
  - (iv) \$600 from S\$ savings accounts placed with DBS Singapore. The account balance represents the advance money placed by PSL to meet the daily cash needs of its staff when rendering services in Singapore.
- (3) Legal and professional fees comprise the following:

	\$
Fees for collection of trade debts – Hong Kong customers	5,000
– Singapore customers	4,000
Professional fees re mandatory provident fund	20,000
Legal fees re a copyright infringement claim by a publisher	10,000
Audit and taxation fees	11,000
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Total	50,000
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- (4) PSL maintains a registered provident fund for its employees and an annual contribution of \$60,000 was provided for the year, representing 20% of all eligible employees' basic salary. The contribution is due for payment in April 2009. PSL has been granted exemption for mandatory provident fund purposes.

- (5) Bank charges and interest comprise the following:

	\$
Bank charges on normal daily operations	8,000
Interest on bank overdraft with HSBC that was secured by the US\$ fixed deposit referred to in (2)(i) above	12,000
Total	<u>20,000</u>

- (6) The exchange gain of \$1,000 was derived from the year end conversion of the S\$ savings accounts balance referred to in (2)(iv) above.

- (7) The provision for accounts receivable shows the following details:

	\$
Balance brought forward – general	(5,000)
Receivables written off – Hong Kong customers	4,000
Amount recovered from Hong Kong customer written off in 2006	(11,000)
Staff loan written off	4,500
Balance carried forward – general	5,500
Total	<u>(2,000)</u>

- (8) Sundry expenses comprise the following:

	\$
Tax late filing penalty	3,000
Compensation for a staff member whose employment was terminated	12,000
Salaries tax for directors	13,000
Singapore personal income tax for staff	17,000
Office consumables (all allowable)	18,000
Total	<u>63,000</u>

- (9) PSL's 2007/08 profits tax computation showed that PSL had a tax loss of \$10,000, but this has not yet been agreed by the Inland Revenue Department. The depreciation allowance schedule showed the following pool balances: 20% pool \$55,000 and 30% pool \$60,000. There is no balance for commercial or industrial buildings.

(10) An extract of PSL's fixed asset movements for the year is as follows:

	Furniture \$	Computers \$	Motor car \$
Cost at 1 January 2008	200,000	200,000	120,000
Additions	40,000	80,000 *	20,000
Disposals	0	(120,000)	(40,000)
Balance at 31 December 2008	240,000	160,000	100,000
Depreciation at 1 January 2008	65,000	140,000	60,000
Charge for the year	24,000	20,000	12,000
Disposals	0	(80,000)	(20,000)
Balance at 31 December 2008	89,000	80,000	52,000
Carrying value at 31 December 2008	151,000	80,000	48,000
Carrying value of disposal	0	40,000	20,000
Proceeds from disposal	0	30,000 **	35,000
Profit/(loss) on disposal	0	(10,000)	15,000

\* Including a \$60,000 system purchased under a hire purchase agreement of 12 months, with a down payment of \$6,000, monthly instalments of \$5,000 and an invoice date of 1 October 2008.

\*\* The disposal was of a computer, the cost of which had been 100% written off in the previous year's tax computation.

**Required:**

- (a) State the general rules regarding the deductibility of interest and use them to explain whether the interest incurred on the bank overdraft under item (5) above is or is not deductible for profits tax purposes.

(4 marks)

- (b) Compute Professional Services Ltd's Hong Kong profits tax liability in respect of the year ended 31 December 2008, clearly identifying both the year of assessment and the basis period, and showing the depreciation allowance calculation.

Notes:

(1) You should ignore provisional tax and overseas tax.

(2) No detailed explanations are required in this part.

(21 marks)

- (c) Subsequent to December 2008, Professional Services Ltd received a payment from the Singapore customer in settlement for its services in Singapore, but net of Singapore tax on profits. The Singapore customer advised that the relevant Singapore tax was deducted from the payment on the basis that the profit from the seminar was taxable in Singapore.

**Required:**

On the assumption that the service income is also taxable in Hong Kong, explain whether Professional Services Ltd is or is not able to claim the Singapore tax payment as a tax deduction for Hong Kong profits tax purposes.

Note: you should ignore any Singapore tax implications.

(5 marks)

**(30 marks)**



- 3 ABC Co was a partnership between Alex, Bonnie and Cherry Ltd. The partnership commenced business in 2005 and makes up its accounts to 31 December. According to the partnership agreement, Alex and Bonnie are each entitled to an annual salary of \$240,000 and the balance of profits or losses is shared amongst the partners in the ratio of 1:1:2 (Alex:Bonnie:Cherry). With effect from 1 July 2008, Alex left the partnership and his profit share was taken up by Andy, Bonnie's husband, but Andy is not entitled to a salary.

In respect of the year ended 31 December 2008, the partnership had the following trading results:

	\$
Gross profit	1,620,000
Rent and rates	(360,000)
Mandatory provident fund contributions	(47,000)
Depreciation	(180,000)
Salaries to Alex	(120,000)
to Bonnie	(240,000)
Loan interest to Cherry Ltd	(200,000)
Interest on capital to Bonnie	(100,000)
Other allowable expenses	(160,000)
Net profit	<u>213,000</u>

Additional information:

- (1) The tax depreciation allowance as agreed with the Inland Revenue Department is \$140,000.
- (2) Rent of \$360,000 was paid to Cherry Ltd, the landlord of the premises in which the partnership business operates. The rateable value of the premises is \$320,000.
- (3) The contributions to the mandatory provident fund scheme included \$24,000 paid for Alex and Bonnie (\$12,000 each).
- (4) Cherry Ltd carries on another business in Hong Kong, for which it had an adjusted loss of \$300,000 for the year ended 30 June 2008.
- (5) Andy and Bonnie claimed personal assessment for the tax year 2008/09 and apart from the partnership business, they had the following income and outgoings for the year ended 31 March 2009:

	Andy \$	Bonnie \$
Salary	100,000	
Rental from Property A	120,000	–
Rental from Property B	–	180,000
Mortgage interest to finance acquisition of the above properties	(90,000)	(200,000)
Profit from proprietorship business (before deduction of approved charitable donations)	40,000	–
Loss from property trading	–	(90,000)
Total approved charitable donations (including those deductible from the proprietorship business)	36,000	–

- (6) Andy and Bonnie have one child, who reached the age of 18 on 30 August 2008. They also maintain Bonnie's brother, who reached the age of 23 on 24 October 2008 and is studying full-time in Australia.

**Required:**

- (a) **Compute the assessable profit/adjusted loss of the partnership for the year of assessment 2008/09 and the tax payable thereon, if any, claiming any relief which is available to Cherry Ltd.**

Note: you should ignore provisional tax. (10 marks)

- (b) **Compute the tax payable by Andy and Bonnie for the year of assessment 2008/09.** (10 marks)

**(20 marks)**

- 4** Black is the director of Power Ltd, a company carrying on business in Hong Kong. In February 2008, Black notified Power Ltd that he wished to retire from his office. Black was persuaded to stay in office, and received a 'compensation payment for agreeing not to retire' of \$500,000 in March 2008.

In May 2008, Black received his composite tax return for the year of assessment 2007/08, and approached his tax consultant for advice about the taxability of the payment of \$500,000. He was told that the payment might not be taxable, and as the Inland Revenue Department would not know about it, he need not report the amount. Black acted on this advice.

In August 2008, Black urgently flew to Canada to take care of his mother who was critically ill. When he returned to Hong Kong on 1 October 2008, he discovered that a salaries tax assessment for the year of assessment 2007/08 had been issued to him, dated 20 August 2008. The assessment included the payment of \$500,000. He also received a notice issued under s.51(3) of the Inland Revenue Ordinance by the assessor, asking him to explain the omission of income from his salaries tax return.

**Required:**

- (a) State the conditions that must be satisfied before an objection against the salaries tax assessment can be lodged and advise Black whether a valid objection can be lodged in his case.** (3 marks)
- (b) Explain whether the objection is likely to be successful.** (4 marks)
- (c) Advise Black of the consequences if he ignores the notice issued by the assessor under s.51(3).** (4 marks)
- (d) Assuming that the payment of \$500,000 was taxable, advise Black whether he has a 'reasonable excuse' for omitting the income from his 2007/08 composite tax return.** (4 marks)

**(15 marks)**

- 5 Abacus Ltd (Abacus) carries on a manufacturing business in Hong Kong, preparing its accounts to 31 December each year.

On 1 February 2007, Abacus purchased a piece of land and built a factory for its own use. The factory was completed on 31 October 2008 and Abacus immediately used it in its manufacturing business. Details of the expenditures incurred on the factory are as follows:

	\$
<b>Year ended 31 December 2007</b>	
Land cost	10,000,000
Construction cost	7,000,000
Loan interest (see note)	725,000
	<u>17,725,000</u>
<b>Year ended 31 December 2008</b>	
Construction cost	2,250,000
Loan interest (see note)	712,500
	<u>2,962,500</u>

**Note:**

	<b>Year ended 31 December</b>	
	<b>2007</b>	<b>2008</b>
	\$	\$
Interest to finance land cost	375,000	300,000
Interest to finance construction cost	350,000	412,500
	<u>725,000</u>	<u>712,500</u>

Interest was incurred evenly throughout the year on a monthly basis.

In February 2009, Abacus sold the factory to Bee Ltd (Bee) for \$28 million (including a land cost of \$16 million). Bee immediately used the factory in its manufacturing business. Bee makes up its accounts to 31 March each year.

**Required:**

**Calculate the depreciation allowances and balancing adjustments where appropriate for both Abacus Ltd and Bee Ltd for all relevant years of assessment.**

**(10 marks)**

**End of Question Paper**